PRAKARSA Policy Brief

August 2022

Cement Industry in North Kendeng Mountains: Environmental Damage, Human Rights Violations and Responsibilities of Financial Institutions

Key Points:

- The cement industry's activities in the North Kendeng Mountains in Rembang and Pati areas not only have caused environmental damage but also violated the rights of the residents
- Banks' flow of credit and financing to the cement industry operating in North Kendeng means that they contribute to business practices that violate human rights and socio-economic rights of residents
- Banks must have credit and financing policies that are based on environment, social and governance (LST), and they must practice them when providing credit and financing to corporations

PT Semen Indonesia's Mining Area, Rembang (photo source: Narasi TV)

The cement industry's practices in North Kendeng have caused environmental damage and human rights violations

Limestone mining practices in the North Kendeng Mountains in Rembang and Pati were initially begun by law violations by the cement companies. Infringements have occurred since the licensing process, where the environmental permits became the main requirement for the companies to access credit or financing from financial institutions. However, the permit process for PT Semen Indonesia did not involve proper socialization and consultation. In the company's Environmental Impact Analysis (AMDAL) document, it was even that 67 percent of residents rejected the cement factory, yet the factory was still established (PRAKARSA, 2022).

The mining activities have caused environmental damage with a domino effect on the survival of the local community. The community's water sources have dried up, and the Groundwater Basin (CAT) water debit has decreased, as well as the water infiltration, causing more frequent floods and landslides. These conditions have impacted a decline in people's income due to the disruption of plant fertility for animal feed and floods that damage agricultural lands. Various changes due to the shift of farming lands have also withered Kendeng community cultures, such as the *brokohan* and *kalungan* traditions, and threatened the existence of the Sedulur Sikep community.

The community has experienced not only environmental damage but also human rights violations. Law enforcement officers and hoodlums committed violence against residents who protested. In addition, the cement industry's existence has contributed to an increase in the number of miscarriages in pregnant women, as these women have been forced to walk quite a distance to find clean water as nearby water sources have been damaged (PRAKARSA, 2022).

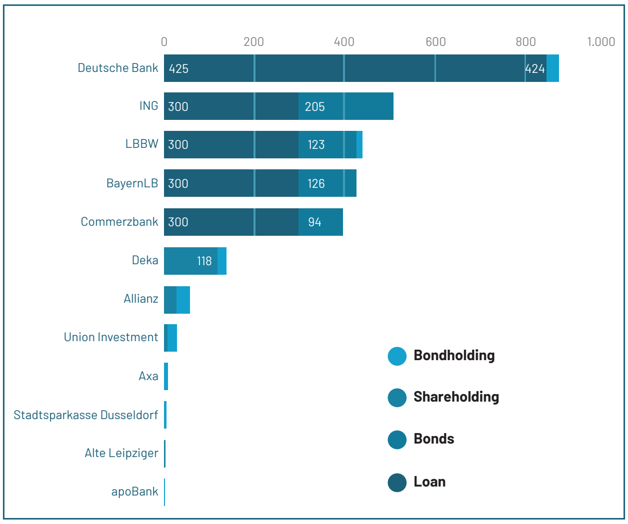
Who is behind the financing and investment in the cement industry in Rembang and Pati?

From 2018 – early 2022, the total flow of financing and investment reached 2.9 billion Euros, provided to HeidelbergCement and PT Indocement Tunggal Perkasa, the parent of PT Sahabat Mulia Sakti operating in Pati Regency (Graph 1). The highest percentage of investment from 2018 to January

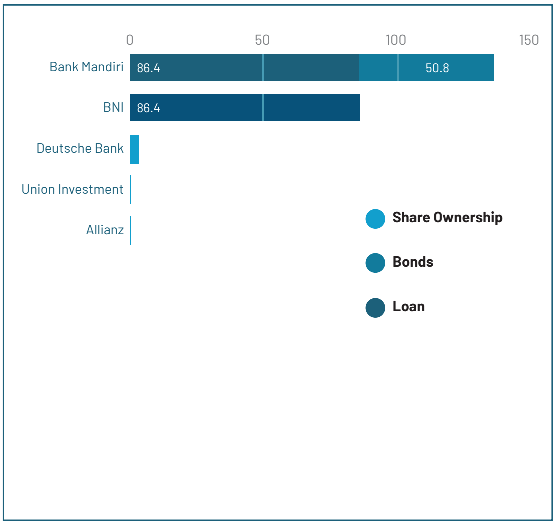
2022 came from loans and bonds from Germany's Deutsche Bank. Other banks that have provided lending include ING, LBBW, BayernLB, Commerzbank, Deka, Allianz, Union Investment, Axa, Stadtsparkasse Düsseldorf, Alte Leipziger, and apoBank (Refinitiv Eikon, 2022).

Meanwhile, the total financing for PT Semen Indonesia (Graph 2) operating in Rembang reached 228.1 million Euros during the 2018-2022 period. The largest sources came from loans of 172.9 million euros, followed by bonds of 50.8 euros and shareholdings of 4.4 million euros. In contrast to HeidelbergCement, the banks involved in financing PT Semen Indonesia mostly came from national banks, namely Bank Mandiri with a funding value of 137.2 million Euros, BNI 86 million Euros, followed by Deutsche Bank, Union Investment and Allianz (Refinitiv Eikon, 2022).

Graph 1. The Largest Investors of HeidelbergCement Group and PT Indocement Tunggal Perkasa 2018 - 2022 (in million Euros)



Graph 2. The Largest Investors of PT Semen Indonesia, 2018 - 2022 (in million Euros)



Source: processed from Refinitiv Eikon, 2022

The data above show that banks and financial institutions still consider investments in Heidelberg Cement, PT Indocement, and Semen Indonesia profitable investments because funds remain flowing until 2022. On the other hand, citizen protests, conflicts, and environmental damage due to the cement companies' mining activities have occurred since 2016. This shows the weak commitment of European banks, such as Deutsche Bank and ING, and national banks, such as Bank Mandiri and BNI, to aspects of people and the planet, especially sustainable finance business practices based on environmental, social and governance (LST). It is clear that banks, in providing loans and financing, only prioritize profit.

The absence of government regulations that specifically regulate and are mandatory results in the weak commitment from these banks and contributes to perpetuating this kind of practice. Bank Mandiri and Bank BNI are part of the First Movers on Sustainable Banking, where their role is considered vital in encouraging sustainable finance in Indonesia. Banks can either provide credit and financing to a responsible business that pays attention to environmental, social and governance aspects (ESG) or finance a destructive business.

Banks' responsibilities in the destructive cement industry activities

Investors and banks' involvement in cement companies indirectly contribute to environmental destruction and human rights violations. The financial industry has responsibility for the business practices of the companies they finance, such as in the case of the cement industry in Rembang and Pati. This is because, first, financial institutions (banks and non-banks) are institutions that provide capital loans to the cement industry. This means that the support from financial institutions will largely determine the continuity of the cement industry's business practices. Second, financial institutions are not only business institutions but also development institutions. Financial institutions collect funds from the public, so funds distributed to business actors need to pay attention to the community's interests. Therefore, the financial industry still feeding loans to irresponsible business practices needs to stop their finance flow to business actors that harm people's lives and damage the environment.

The Financial Services Authority (OJK) has established a Phase II Sustainable Finance Roadmap (2021 - 2025) to accelerate the implementation of ESG principles in Indonesia. This roadmap is directed at accelerating the creation of a comprehensive sustainable financial ecosystem, involving all parties and encouraging the development of cooperation between the parties. This roadmap becomes the basis for the financial industry in setting its business policies and practices to move from conventional business to innovative business by paying attention to sustainable socio-economic development.

In 2022, OJK issued an Indonesian Green Taxonomy containing definitions and guidelines on green activities. Through the Taxonomy, OJK classifies economic and business activities that can support environmental protection and management and climate change mitigation and adaptation. However, the institution has not established a Book of Credit/Financing in the extractive or natural resource (SDA) processing sector.

Why banks are not implementing responsible financing

PRAKARSA (2022) identifies two main factors that cause banks to continue disbursing funds to companies that cause environmental damage and human rights violations, as in the case of the cement industry in Pati and Rembang. First is the absence of binding policies from the financial sector regulators to stipulate responsible financing. Second, there is a gap between the banks' internal policies and the credit and financing practices carried out. Credit and funding made by banks are considered irresponsible if the banks do not have policies related to climate change, human rights, and the mining sector business.

The first factor is the absence of binding policies that can result in a weak bank commitment to be more selective and careful in distributing credit and financing by integrating environmental and social factors. In the Rembang and Pati Regencies cement industry, such bank policies are absent in Bank Mandiri and BNI. In managing climate change risk, the policies of these two banks are still limited to bank operations and do not cover their credit, financing, and investment activities. Both banks do not yet have a policy that requires financed clients to disclose their emission expenditures in their public reports.

Analysis based on the results of an assessment conducted by Responsibank Indonesia (2022) reveals that in the social aspect, Bank Mandiri and BNI also do not have policies that require their clients to have human rights due diligence procedures to identify, prevent, and minimize the impact of business on society, the community, indigenous peoples, and vulnerable communities including children and persons with disabilities. These two banks also do not have safeguards and risk management related to human rights in their credit, financing, and investments. In the mining aspect, the two banks have not required their clients to avoid the development of projects or businesses in certain areas that have the potential to damage or harm the environment and have not required their clients to analyze the impact of their undertakings or enterprises on the sustainability of springs and implement mitigation measures to address water needs for the community and ecosystem.

The second factor contributing to the irresponsible financing of the cement industry in Rembang and Pati is the non-implementation of policies by Deutsche Bank. Unlike the case with Bank Mandiri and BNI, Deutsche Bank already has a policy that regulates the minimum requirements for financed clients and a list of prohibited business activities (exclusion list) by adopting best practice standards. Furthermore, Deutsche Bank is actively involved in global initiatives that promote sustainable finance. However, the Bank continues to finance companies engaged in human rights violations and environmental damage, such as the Rembang and Pati Regencies cement industry. In short, Deutsche Bank already has the policy but does not implement it well.

Conclusion and Policy Recommendations

Environmental damage and human rights violations due to the mining and cement industry activities in the North Kendeng Mountains in Rembang and Pati have occurred since the licensing process was undertaken. The business and mining practices persisted even though their license was acquired without a comprehensive consultation process and community involvement. Although most residents refused, exploitation activities are still executed.

The various consequences caused by the business practices could have been mitigated if the financial industry had implemented responsible financing and good sustainable finance. As a financing power, the financial services sector (SJK) can influence the decision-making of the business activities it funds to be more responsible. However, there are yet to be environmental and social risk management policies in financing and investment activities carried out by banks and investors, and the existing policies are not implemented. These two factors contradict the commitment to sustainability aspects in financing and investment by banks.

Therefore, PRAKARSA provides several recommendations:

1. Banks and investors, both international and national, must stop financing and investing in the cement industry companies that are involved in environmental damage and violation of the rights of residents in the North Kendeng Mountains, Rembang and Pati areas.

2. Banks must have an environmental and social risk management system (ESMS) consisting of policies and procedures, due diligence and monitoring and evaluation to identify and manage the risks and impacts of their financing and investment activities. Banks must also have a grievance mechanism and involve various stakeholders, including civil society organizations, to seek information related to impacts on the ground and cases of client violations. Beyond the internal level, banks must also require their clients to have such a mechanism.

3. The Financial Services Authority (OJK) must establish a Credit/Financing Book in the extractive sector or natural resource processing. In addition, OJK needs to include the limestone mining and cement production industry in the "yellow" category in the Green Taxonomy if it meets strict environmental and social criteria and in the "red" category if it does not meet these criteria. Social criteria such as gender and human rights need to be a requirement that must be complied with in addition to environmental and other social extents. Policy standards should adopt not only national regulations but also international best practice standards.

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PRAKARSA Policy Brief is an independent policy analysis and recommendation about various critial issues related to development and welfare.

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